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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Statutory Review of The System for Regulating Rates and Classes for Market-Dominant Products — **Docket No. RM2017-3**

COMMENTS OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO ON THE REVISED NOTICE OF PROPOSED RULEMAKING FOR THE SYSTEM FOR REGULATING RATES AND CLASSES FOR MARKET DOMINANT PRODUCTS

(February 3, 2020)

On December 1, 2017, the Commission gave notice that, having concluded in Order No. 4257 that the market dominant products rate-setting system failed to meet the statutory objectives taking into account the factors of the Postal Accountability and Enhancement Act of 2006 (PAEA), changes in the system were appropriate and necessary through rulemaking. After consideration of comments concerning the earlier proposed regulations, on December 5, 2019, the Commission issued a Revised Notice of Proposed Rulemaking in Order No. 5337. The American Postal Workers Union, AFL-CIO (APWU) submits these comments concerning the revised proposed NPR.

I. Supplemental Rate Authority

A. Density

The Commission concluded in Order No. 4257 that the rate-setting system for market-dominant products has failed to provide financial stability to the Postal Service.[1]

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[1] ORDER No. 4257 at 148 ("Finally, applying the objectives in conjunction with one another, the Commission analyzes the overall financial health of the Postal Service as determined by its analysis described above. The Commission concludes that although the statutory compliant CPI-based price cap system was anticipated, at the time of its implementation, to enable the Postal Service to produce sustained net income and generate retained earnings, that has not occurred. Consequently, the system has not resulted in a financially stable Postal Service.").

As APWU previously commented, the solution to this problem is that the price cap in the PAEA should be eliminated.[2] The price cap has not worked; APWU suggests that it has actually caused the problems the Commission has acknowledged. Retention of the price cap with supplemental authority as the Commission is proposing would be an improvement over the current situation; but as designed, the supplemental authority is too little too late. APWU criticized the earlier proposed rulemaking of 2% additional rate authority because it was based on FY 2017 shortfalls which were not representative of typical losses and did not provide an actual "true up" returning a balance between expenses and revenues.[3] In the revised proposed rulemaking, the density rate authority formula and its rationale avoid some of the criticism APWU leveled concerning the 2%. It is still, however, inadequate to fully return the Postal Service to financial stability.

The Commission properly recognizes that a decline in density can drive an increase in unit cost unrelated to inflation and beyond the ability of the Postal Service to recover with the CPI price cap.[4] The Commission notes that density has been declining "over the past several years."[5] However, Table IV-3 shows seven consecutive years of

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[2] Docket No. RM2017-3 COMMENTS OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO ON THE NOTICE OF PROPOSED RULEMAKING FOR THE SYSTEM FOR REGULATING RATES AND CLASSES FOR MARKET DOMINANT PRODUCTS (March 1, 2018) at 3; Docket No. RM2017-3 COMMENTS OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO (March 20, 2017) at 29-31; Docket No. RM2017-3 REPLY COMMENTS OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO ON THE NOTICE OF PROPOSED RULEMAKING FOR THE SYSTEM FOR REGULATING RATES AND CLASSES FOR MARKET DOMINANT PRODUCTS (March 30, 2018) at 2-3.

[3] Docket No. RM2017-3 COMMENTS OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO (March 20, 2017), Part II.A at 3-12.

[4] ORDER No. 5337 at 70-71.

[5] ORDER No. 5337 at 70.

density decline.[6] The National Association of Letter Carriers carried the comparison back further, finding eleven consecutive years of density decline.[7] The Commission is proposing prospective rate authority. With the likely timing of final regulations, the initial rate authority based on density might be available for 2021 based on the change from FY 2019 to FY 2020. This leaves twelve years of rising unit costs due to density decline unadjusted, and four years since the Commission began its review.

The formula the Commission is proposing lags behind actual cost increases. Any rate authority becomes available sometime *after* the Postal Service has experienced rising unit costs. How far after is hard to measure. It is now months after the close of FY 2019 and the necessary TFP data for the density calculation is not yet public. Will the data be available soon enough for the usual January rate increases or will there be a year delay before the Postal Service can use any supplemental density rate authority?

APWU judged as inadequate the 2% supplemental rate authority in the initial December 1, 2017, proposed rulemaking. The supplemental density rate authority the Commission now proposes will likely generate less, although it is an improvement in that it continues beyond five years. Table IV-3 shows only one year – 2013 – where the formula produces more than 2%. Most years are substantially below 2%. The NALC's analysis suggests that rates would have been higher than 2% for 2009 and 2010 as well as 2013. Only combining the density rate authority with the additional supplemental retirement rate authority might there be a total of 2% supplemental rate authority. But, the inherent limitation in the Commission's design that revenue raised by the supplemental

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[6] ORDER No. 5337 at 80.
[7] Docket No. RM2017-3 COMMENT OF THE NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL-CIO (January 30, 2020) p. 6.

retirement rate authority is specifically earmarked to go to the Department of the Treasury means that the revenue it generates cannot be used for operations. Left with only the density authority, the Postal Service has little additional authority to address the very problems the Commission identified.

The annual Δ change accruing from the density decline formula produces 19.1% of rate authority for FY 2009 through FY 2019. For 2017, 2018, and 2019, the formula produces 3.3%. The Postal Service should receive rate authority related to this history of density decline. The Postal Service should also be permitted to bank this authority to use over several years.

B. Amortization and the Supplemental Retirement Rate Authority

Without additional rate authority the Postal Service cannot make the amortization payments required by the PAEA. If forced to pay, it will be at the expense of service and further retard needed investment.

As well as amortization payments, the Office of Personnel Management bills the Postal Service for normal costs. These normal costs exceed the amortization payments.[8] Without additional rate authority, the Postal Service will likely continue to default. If forced

[8] The Postal Service reports that "In 2017, the PSRHBF began funding the Postal Service's share of retiree health benefit premiums, and we were required to begin paying the "normal costs" of retiree health benefits (i.e., the present value of the estimated retiree health benefits attributable to active employees' current year of service) into the PSRHBF, as well as an amortization payment of our unfunded liability. For the years ended September 30, 2019, 2018, and 2017, the amounts OPM billed us for normal costs were $3.8 billion, $3.7 billion and $3.3 billion, respectively, and the amounts billed for amortization payments were $789 million, $815 million and $955 million, respectively. We did not make any of these 2019, 2018 or 2017 payments totaling approximately $13.3 billion as of September 30, 2019, in order to preserve liquidity and to ensure that our ability to fulfill our primary universal service mission was not placed at undue risk. The total accrued but unpaid amount due to the PSRHBF was approximately $47.2 billion as of September 30, 2019. As of the date of this report, we have not incurred any penalties or negative financial consequences as a result of not making the PSRHBF statutorily set prefunding, normal cost, or amortization payments." USPS 2019 Report on Form 10-K at 6.

to pay, it will be at the expense of service and further retard needed investments. The Commission should consider normal costs in this rulemaking.[9]

II. Performance-Based Authority

The revenue from additional rate authority through a performance-based concept is desperately needed for the Postal Service to make investments in the postal network. The Commission should change the performance benchmark for operational efficiency. Although the revised rulemaking is an improvement over the initial proposal, the TFP benchmark should be replaced by a capital investment plan benchmark to incent Postal Service plans and actions consistent with the Commission's reasoning for proposing a performance-based rate authority in the first place.

The Commission bases its proposed performance-based rate authority on the need for the Postal Service to earn revenue to generate retained earnings from which it can make capital investments. The Commission notes repeatedly that these capital investments are the lynchpin to the Postal Service improving service as well as increasing operational efficiency, i.e. higher productivity and lower operational costs. (Order No. 4258 at 46, 47, Figure III-2 *Financial Health Cycle*, 52 ("The Postal Service's sharp decline in capital investments contributed to the system not achieving Objective 1 ('maximize incentives to reduce costs and increase efficiency'), Objective 3 ('maintain high quality service standards established under section 3691"), and Objective 5 ('assure adequate revenues, including retained earnings, to maintain financial stability').").) But the

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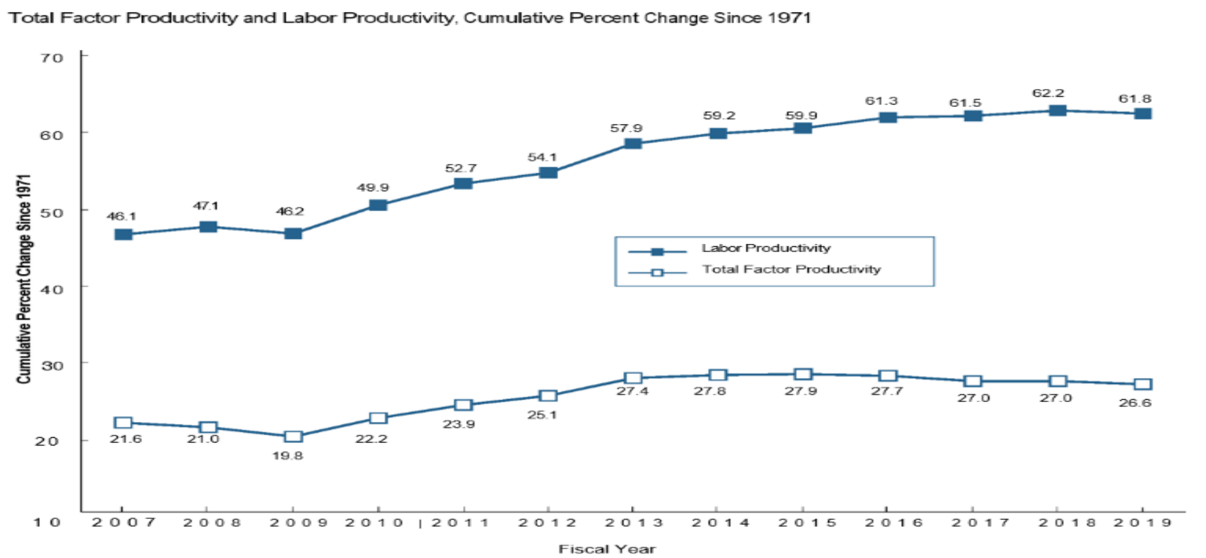
[9] The Commission is aware that retirement liabilities would diminish and perhaps disappear with better husbanding of monies in the various retirement funds. There is pending legislation that could eliminate the Postal Service's current unfunded PSRHBF liability payment obligations. It is certain to pass the House. Postal stakeholders often pull in different directions, as they will in this docket; but there is virtual unanimity among stakeholders in pressuring Congress for relief on retirement liabilities.

requirement of positive TFP growth to get the performance-based rate authority puts the cart before the horse -- the Postal Service's opportunity to raise additional revenue for capital investments using the performance-based authority is earned by the Postal Service first demonstrating improved productivity *without* access to the capital the performance-based rate authority would produce. To generate the revenue from the performance-based rate authority, the Service must first demonstrate that it can perform well without the capital the additional authority would generate.

Although the Postal Service TFP measure has generally shown year-to-year growth, such growth can't be taken for granted. At moments when volume falls quickly [FY 2008 and FY 2009] or mail mix changes significantly or the Postal Service needs a lot of resources to fix a problem, e.g., poor service performance [FY 2016],[10] TFP can go negative. Should the Postal Service let service degrade so TFP stays positive? These are moments when capital investment can promote smart solutions rather than degradation of service. TFP fell in FY2019.

[10] USPS FY2016 Annual Report to Congress at 35.

The following chart from the USPS FY2019 Annual Report to Congress shows historical Postal Service Total Factor Productivity:



Part of the TFP measurement is the performance of capital. When capital expenditures are relatively small, as they have been, a larger share goes to fixing roofs and other things which may actually have negative ROIs. Paucity of capital can itself be a drag on TFP measurement.

The Commission should note that with little money for capital improvements, the Postal Service must spend those dollars on keeping its facilities open [over 40% of capital expenditures in recent years] [11] and its fleet on the road. It is estimated that the Postal Service spends about $4,500 on maintenance per vehicle per year.[12] Monies spent on

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[11] "The 2019 capital commitment plan for facilities is $0.8 billion and represents approximately 44 percent of the total capital commitment plan. These investments are primarily for building improvements, which include repairs and alterations to aging buildings, and facility modifications that are necessary to accommodate current and future operational needs. In addition, a small portion is for construction and building purchases." Fiscal Year 2019 Integrated Financial Plan at 6.

[12] US Postal Service Projected Capital Spending and Processes for Addressing Uncertainties and Risks, GAO Report GAO-18-515, June 2018.

deferred maintenance in older facilities or remanufacturing unavailable parts for thirty-year old vehicles is essential to continued operations and must be spent in preference to other investments; but the return on investments like these can be negative.

The Postal Service has a long list of capital projects that would achieve more efficiency and productivity; expand products and services; and improve service; but it will put some on the backburner and others it will roll out over many years.

- The replacement delivery vehicle fleet is estimated to cost $6.3 billion to be replaced in a 5-7-year period starting in 2020.[13] The new fleet would be more reliable and safer, reduce fuel consumption, reduce maintenance costs, have sufficient load capacity to reduce the number of returns to station to get mail that couldn't fit in the vehicle. The fleet should have been replaced years ago. It needs to be replaced in short order. Five years is too long; but without the sufficient capital, it will likely take closer to ten years. If done quicker it will be at the expense of other important investments.
- Enhanced Package Processing System. The Postal Service plans for at least ten of these.[14] Only two are in operation. The cost for each system is in the tens of millions.

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[13] Postal Service Wrapping Up Testing of New Mail Truck Prototypes, February 4, 2019
https://www.trucks.com/2019/02/04/postal-service-wrapping-testing-mail-truck-prototypes/

Postal Service Readying Production Contract for New Mail Truck, January 13, 2020
https://www.trucks.com/2020/01/13/postal-service-readying-production-contract-for-new-mail-truck/

[14] Postal Service Taps Lockheed for $215M Package Sorting Tech Supply IDIQ, Nov 8, 2017
https://www.govconwire.com/2017/11/postal-service-taps-lockheed-for-215m-package-sorting-tech-supply-idiq/

- The Postal Service wants to install a significant number of Universal Sorting Systems, High Throughput Package Sorters and each of these systems cost multiple millions.
- Automated Guided Vehicles combined with all the related IT, AI, and facility modifications could be a billion-dollar investment.[15]
- The Postal Service has other ambitious and necessary plans for automation and technology.[16]

The Commission correctly concludes that capital investment is vital to the Postal Service improving its efficiency and ultimately improving service – capital investment is, the Commission concludes, a critical part of the Postal Service's financial cycle and sustainability. (Order No. 4258 at 53.) The Commission also found that capital outlays have consistently and sharply decreased since passage of the PAEA, and that the steep decline in capital investments has contributed to the system failing to meet many Objectives. (Order No. 4258 at 52, 54.) Since that finding investments continue to be enervated.[17] The Commission directed that revenue from the performance-based authority be used to return the Postal Service to its pre-PAEA rate of capital investment.

[15] Autonomous Mobile Robots and the Postal Service, USPS-OIG Report Number RARC-WP-18-006, April 9, 2018.

[16] Review of Information Technology Network Performance, USPS-OIG Report Number 18TG005IT000-R20, January 17, 2020.

[17] "Our capital expenditures have declined from an annual average of approximately $1.5 billion in years 2009 through 2011 to an annual average of approximately $1.4 billion in years 2015 through 2019, a reduction of approximately 7%. However, we will need to increase our capital expenditures in order to address our aging facilities and delivery fleet and to upgrade our equipment to remain competitive in the marketplace and to ensure that we will be able to continue to meet our statutory obligation to provide prompt, efficient and reliable postal services to the nation." 2019 Report on Form 10-K at 40.

(Order No. 4258 at 54.) But the mechanism in the revised NPR may not achieve that goal and the pre-PAEA may not be the right rate.

The faster the Postal Service can invest and deploy, the faster the return. However, there is usually a delay between expenditure and the productivity and efficiency gains. This argues for accruing capital upfront – not in out years, if and after the Postal Service achieves positive TFP.

The Postal Service sounded an alarm:

> *Due to our recent and projected cash constraints, our operational performance in the future could be at risk as a result of inadequate capital investment in facilities, delivery vehicles, mail processing equipment or information technology infrastructure, all of which are essential for our operations. If our operations do not generate the liquidity we require, we may be forced to reduce, delay or cancel investments in technology, facilities and/or transportation equipment, as we have done in the recent past, while our competitors and other businesses are pursuing advanced, competing technologies and equipment. Additionally, our aging facilities, equipment and transportation fleet could inhibit our ability to be competitive in the marketplace, deliver a high-quality service and meet the needs of the American public. The changes in the economic landscape in recent years have increased the importance for us to invest in our operations in order to remain competitive. Failure to anticipate or react to our competition, market demands and/or new technology due to inadequate cash reserves is a significant operational risk. An aging or potentially obsolete infrastructure could result in a loss of business and increased costs.*

2019 Report on Form 10-K at 12.

Look for a moment to other transportation and delivery companies to see their level of investment:

- FedEx capital expenditures in FY 2017 were $5.1 billion ($1.8 billion was aircraft), $5.7 billion ($2.5 billion was aircraft) in FY 2018, $5.5 billion ($2.2 billion in aircraft) for FY 2019 and $5.9 billion is expected in FY 2020. In FY2019 FedEx spent $2.5 billion on package handling equipment, vehicles and information technology. [FedEx 10-K FY2019].
- UPS capital expenditures for FY 2017 were $5.2 billion (of which $800 million was aircraft) and for FY 2018 it was $6.3 billion (of which $1.5 billion was aircraft). In FY 2018 UPS spent $1.6 billion on vehicles and IT equipment; [UPS 10-K FY2018].
- Amazon capital expenditures were over $11 billion in FY 2018 which included building facilities. [Amazon 10-K FY2018].

Rather than using positive TFP growth as the benchmark for the performance-based rate authority, the Commission should provide additional rate authority sufficient to fund a Postal Service capital outlay and investment plan. The Commission observes that the Postal Service calculates Total Factor Productivity annually and files it with the Commission outside of the rate-setting process, and that exercise can and should continue for the Commission to address the myriad of related issues surrounding TFP in those other proceedings. (Order No. 4257 at 205, 207.) The performance-based rate authority should be linked to capital investment plans. This is objective, achievable, and keeps the rate-setting process streamlined and efficient.

III Conclusion

The supplemental rate authority should be modified as regards the density rate authority to provide the Postal Service with additional rate authority for accumulating declines in density. The proposed formula produces 19.1% of rate authority over the term of the PAEA and 3.3% picking up after the tenth year under the PAEA. The Postal Service should be able to bank this authority to use over several years.

The supplemental rate authority should be modified as regards the amortization of retirement liabilities to include normal costs as well as amortization costs.

The performance-based rate authority should be tied to a capital investment plan and not to TFP performance. The performance-based rate authority should not be limited to 1% per year. It should be set to raise revenues needed for the capital investment plan.

Respectfully submitted,

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/s/

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